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FISCAL IMPACT STATEMENT

LS 6813 | **NOTE PREPARED:** Jan 4, 2004
BILL NUMBER: HB 1332 | **BILL AMENDED:**

SUBJECT: Tax Incentives.

FIRST AUTHOR: Rep. Espich | **BILL STATUS:** As Introduced
FIRST SPONSOR:

FUNDS AFFECTED: X **GENERAL** | **IMPACT:** State
X **DEDICATED**
FEDERAL

Summary of Legislation: *R&D Sales Tax Exemption:* This bill exempts purchases of research and development equipment from Sales Tax.

Corporate Income Tax Apportionment Formula: The bill provides that, for purposes of the Indiana Adjusted Gross Income tax, business income is apportioned based on the sales factor. The bill eliminates the property factor and payroll factor that are currently also used in apportioning income.

Research Expense Credit: It makes the Research Expense Income Tax Credit permanent.

Effective Date: July 1, 2004; January 1, 2005.

Explanation of State Expenditures: The Department of State Revenue will experience additional expenses to revise tax forms, instructions, and computer programs to incorporate the above changes.

Explanation of State Revenues: *R&D Sales Tax Exemption:* The bill exempts certain research and development (R&D) equipment sales from the state's Sales Tax beginning July 1, 2004. The exemption is estimated to reduce Sales Tax revenue by $23 M to $57 M in FY 2005, and by approximately $26 M to $64 M in FY 2006.

Sales Tax revenue is deposited in the: Property Tax Replacement Fund (50%), the state General Fund (49.192%), the Public Mass Transportation Fund (0.635%), the Commuter Rail Service Fund (0.14%), and the Industrial Rail Service Fund (0.033%).

The Sales Tax estimate above is based on data obtained from the National Science Foundation (NSF) that describes the total value of industrial research and development performed in Indiana through CY 2000. Based on past R&D expenditures and adjusting for growth, it was estimated that in FY 2005, Indiana firms will expend a total of approximately $2,984 M on R&D in Indiana. In FY 2006, these expenditures are expected to increase to $3,047 M. Using NSF information on how R&D funds are spent, it was estimated that approximately 14% to 35% of Indiana R&D expenditures would be subject to the state's 6% Sales Tax.

Corporate Income Tax Apportionment Formula: The proposed change in the apportionment formula is likely to decrease Indiana Corporate Income Tax revenues. The estimation of the magnitude of the decrease in revenues is under review.

Background: The apportionment formula is used to determine Indiana Adjusted Gross Income for corporations whose income is derived from sources both within and outside Indiana. Currently, a three-factor apportionment formula is used to determine Indiana Adjusted Gross Income. The formula includes property, payroll, and sales (also called receipts) to allocate business income to the state. The sales factor is double weighted. The current formula is shown below.

$$\left[\frac{\text{Indiana Property}}{\text{Total Property}} + \frac{\text{Indiana Payroll}}{\text{Total Payroll}} + 2*\left(\frac{\text{Indiana Sales}}{\text{Total Sales}}\right)\right] \div 4$$

The bill would eliminate the property and payroll factors in the apportionment formula and the double weight of the sales factor. A corporation's adjusted gross income would be determined by a single-factor formula which measures Indiana sales as a proportion of total sales in the United States. The new formula is shown below.

$$\frac{\text{Indiana Sales}}{\text{Total Sales}}$$

Corporate income taxes are distributed to the General Fund and the Property Tax Replacement Fund.

Research Expense Credit: This credit is currently set to expire on December 31, 2013. This bill would eliminate the expiration date and make this credit permanent. It is difficult to estimate the exact impact of continuing this tax credit indefinitely since it is dependent on both the amount of research expenses individual taxpayers make during the year and their total tax liability. This permanent extension would affect revenue collections beginning in FY 2014 and years after.

Background: P.L. 242-2002 (ss) increased this credit from 5% to 10% of qualified expenses for tax years beginning January 1, 2003, and eliminated the apportionment factor used to calculate the credit. P.L. 224-2003 extended this tax credit until December 31, 2013. The total estimated cost of this credit at the higher rate is expected to range from approximately $50 M to $75 M annually. Over the past six years when the credit was set at a 5% rate, the Research Expense Credit has ranged from a low of $9.2 M in FY 1996 to a high of $24.2 M in FY 1999. In FY 2000 $19.4 M were claimed, and in FY 2001 $21.9 M were claimed at the 5% rate. No data is available on the amount of credits which might be claimed under the changes made by P.L. 242-2002(ss).

With additional incentives created for research and development activity based in the state of Indiana, the revenue loss from this credit could increase by an indeterminable amount. The credit provides $100,000 for each $1 M in new research expenses. Increased expenditures on research activities could also generate additional Adjusted Gross Income and Sales Tax revenue if these expenses are used to hire additional employees or purchase related equipment.

The Research Expense Tax Credit affects revenue collections deposited in the General Fund and the Property Tax Replacement Fund.

Explanation of Local Expenditures:

Explanation of Local Revenues:

State Agencies Affected: Department of State Revenue.

Local Agencies Affected:

Information Sources: Department of State Revenue.

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